

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Richard Jones
Taxpayer Advocate Service

from: Catherine L. Campbell
Attorney (Seattle, Group 2)
(Small Business/Self-Employed)

subject: LLC

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ISSUE

 , LLC , a multimember limited liability company (LLC) that did not elect to be an association taxed as a corporation, incurred liability for employment taxes. Subsequently, became a single member LLC that was disregarded as an entity for federal tax purposes. Can the employment taxes incurred by during the time it was a partnership for federal tax purposes be collected from the property of the individual single member of the disregarded entity, ?

CONCLUSION

The unpaid employment taxes incurred by at the time it was a multimember LLC taxed as a partnership cannot be collected by levy on then individual bank account of .

FACTS

, LLC was created in the State of Washington on . The place of business for on the most recent annual report filed with the State of Washington is

. The LLC had two members, and a Washington LLC. The address for on the Limited Liability Company Agreement is .

According to the Taxpayer Advocate Service (TAS) technical advisor, did not elect to be an association taxed as a corporation by filing an Entity Classification Election (Form 8832) under the check-the-box regulations, Treasury Regulation § 301.7701-1 et seq.¹

incurred liability for unpaid payroll taxes (Form 941) for the second, third, and fourth quarters of 20 and the first quarter of 20 and Federal Unemployment Tax (Form 940) for 20 .

On or about July 16, 20 , and , a 50 percent owner of , entered into a Member Interest Redemption and Settlement Agreement. Emergent assigned all its interest in to in complete redemption of membership interest. assumed all liabilities incurred by from the date of its creation to the date of the redemption, including liability for federal taxes.

On September 17, 2007, the Service assessed unpaid payroll taxes, penalties and interest for the second, third, and fourth quarters of 20 and the first quarter of 20 against , a partnership. The Service also assessed the FUTA tax of 20 on November 19, 20 . On October 26, 20 , the revenue officer issued final notice of intent to levy with respect to those taxes to and as "single member." On , the revenue officer filed a Notice of Federal Tax Lien to secure the unpaid payroll taxes in County, Washington against . A Notice of Federal Tax Lien securing the unpaid FUTA tax for 20 was filed against LLC on .

¹ Neither did file an election to be taxed as a subchapter S corporation.

On _____, a Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320 was mailed to _____." On November 27, 20_____, the revenue officer requested that the entity name be changed in the Service's IDRS records from _____²

On August 13, 2008, the revenue officer issued levies to _____ and _____ to collect the unpaid payroll taxes for the second, third, and fourth quarters of 20____ and the first quarter of 20____ and Federal Unemployment Tax (Form 940) for 20____. The levy identified the taxpayer as _____ and levied his personal accounts. His social security number was the identifying number on the levies. The levies stated that the levies attached to accounts of _____ as owner of _____, LLC, but not to accounts in the name of _____, LLC which were also maintained at the banks upon which the levies were served.

No liability has been assessed against _____ as the person responsible for collecting and paying over the trust fund portion of the payroll taxes of _____ under I.R.C. § 6672.

_____ seeks relief through the TAS on the ground that the levy on his individual bank accounts to collect the liability of the LLC incurred when it was taxable as a partnership was improper. The taxpayer advocate has concluded that _____ is correct and seeks Counsel's concurrence.

LEGAL ANALYSIS

_____ was formed in the State of Washington as an LLC with two members in 20____. During the time the unpaid employment taxes at issue were incurred _____ was a multimember LLC that had not elected to be an association taxed as a corporation.

An LLC with two or more members may elect to be treated for federal tax purposes as an association taxable as a corporation.

²

_____ was the managing member of _____.

Treas. Reg. § 301.77-1-3(a). If the LLC does not make such an election, the LLC will be treated for federal tax purposes as a partnership. An LLC in Washington State can have just one member. R.C.W. § 25.15.005(4). Like a multimember LLC, a single member LLC may elect to be treated as an association taxed as a corporation for federal tax purposes. If no election is made, the single member LLC is disregarded as an entity separate from its owner. Treas. Reg. § 301.7701-3(b)(1)(ii). The activities of the LLC are treated the same as a sole proprietorship of the owner. Treas. Reg. § 301.7701-2(a).

In this case, _____ was a multimember LLC taxable as a partnership when the liability was incurred. Under state law, partners in a general partnership are liable for the debts of the partnership. R.C.W. § 25.05.125 (with certain exceptions not relevant here). However, an LLC is a hybrid entity with attributes of a general partnership but cloaked with the aspect of corporate limited liability. If, under state law, the members of the LLC are not liable for the debts of the LLC, then, absent fraudulent transfers or other special circumstances, the Service may not collect the LLC's employment tax liability from the members including by levy on property and rights to property of the members. Rev. Rul. 2004-41, 2004-1 C.B. 845. Washington law provides that members of an LLC are not personally liable for the LLC's debts and obligations. R.C.W. § 25.15.125. Therefore in Washington, the LLC is the employer for purposes of federal employment tax liability. Rev. Rul. 2004-41, 2004-1 C.B. 845.; see also IRS CCA 200235023, 2002 IRS CCA LEXIS 66. We have identified no special circumstances that would enable the Service to collect the taxes at issue from the members' property. In this case, the multimember LLC _____ was liable for the unpaid employment taxes, not its individual members, _____ and _____.

Subsequent to the LLC incurring the unpaid tax debt at issue, the LLC redeemed the 50 percent interest of _____, LLC. After the redemption, _____ was a single member LLC that had assumed the liabilities incurred prior to the redemption. The LLC liable for the debt continued with one member; however, that member continued to be protected under state law from liability for the obligations of the LLC. No provision of state law renders the member liable for the LLC's obligations because of the change in membership.

After _____ became the single member, the LLC did not make an election to be taxed as a corporation. Therefore, the entity was disregarded and treated as a sole proprietorship. For wages paid prior to January 1, 2009, the owner of the disregarded entity, i.e. the individual, is the employer for employment tax purposes, the same as a sole proprietorship. Treas. Reg. § 301.7701-2(a); see Kandi v. United States, 2008 TNT 190-20 (9th Cir. unpublished opinion).³

Upon the redemption of the interest of the withdrawing member of the LLC, the LLC was disregarded for tax purposes so _____, as the single member, became liable for employment taxes incurred subsequently by the LLC. But that is irrelevant to the question whether the event of the member's withdrawal terminated the limited liability of the members of _____ for the liability of the LLC for the employment taxes incurred when it was a multimember LLC taxed as a partnership.

Treas. Reg. § 301.7701-2(c)(2)(iii) provides that an entity that is otherwise disregarded as separate from its owner is treated as an entity separate from its owner for purposes of federal liabilities of the entity with respect to any taxable period for which the entity was not disregarded. Because the taxable periods involved in this case date back to when the taxable entity was a multi-member LLC that was not disregarded, _____ and his property cannot be liable for taxes incurred during those periods. By virtue of the redemption and settlement agreement, the LLC itself remains liable for the unpaid taxes and its property may be levied against.

³ That regulation has been revised to render a single-member LLC liable for employment taxes as the employer, even though it is disregarded for other federal tax purposes. Because the revised regulation is effective for wages paid on or after January 1, 2009, it has no effect on the analysis in this case.

Please call Cathy Campbell at 206-220-5637 if you have any questions.

PATRICIA A. DONAHUE
Area Counsel
(Small Business/Self-Employed:Area 7)

By: _____
Catherine L. Campbell
Attorney (Seattle, Group 2)
(Small Business/Self-Employed)